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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-119

IN THE MATTER OF BECK INDUSTRIES, INC.,
Debtor.

TRUSTEES OF BECK INDUSTRIES, INC.,
Petitioners,

v.

JACK FELDMAN, ET AL.,
Respondents.

BRIEF FOR RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit (Appendix to Petition, pp. 19a-41a) is unreported as of this date. No opinion was issued by the Court of Appeals in denying Petitioners' petition for rehearing. The opinion of the United States District Court for the Southern District New York (Appendix to Petition, pp. 14a-18a) is reported at 348 F. Supp. 397 (1972). The opinion of the Referee in Bankruptcy (Appendix to Petition, pp. 1a-13a) is unreported.

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition.

QUESTION PRESENTED

Whether the Bankruptcy Court had jurisdiction to enjoin the Respondents from prosecuting their suit in the Maryland State Courts against a solvent wholly-owned subsidiary of a Chapter X debtor?

STATUTES INVOLVED

The pertinent provisions of the Bankruptcy Act and the Internal Revenue Code are set forth in the Petition at pp. 2-4.

STATEMENT OF THE CASE

The Respondents, Jack Feldman, et al.,* (hereinafter "the Feldmans"), instituted a suit in the Circuit Court of Baltimore City, Baltimore, Maryland against a solvent, wholly-owned subsidiary of Beck Industries, Inc. (hereinafter "Beck"), which is a debtor under Chapter X of the Bankruptcy Act, 11 U.S.C. §501, *et seq.* In the Maryland suit the Feldmans seek to rescind a merger agreement entered into by and between a subsidiary of Beck (hereinafter "Subsidiary") and a corporation in which the Feldmans owned approximately sixty five percent of the stock, Webster Clothes, Inc.

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* Jack Feldman, Nancy I. Feldman Gimbel; Abraham Feldman; Lena Feldman; Julius Feldman; Selma Feldman; Helen W. Feldman; Abraham Feldman and Edward E. Obstler, Personal Representatives for Louis S. Feldman, deceased; Doris Feldman Hyatt; Leba Ann Feldman Rotker; Florence L. Kobernick; Linda D. Duritz; Rose Feldman; Norma Feldman Schrago; Bernice Elaine Suser; Stephen Suser; Abraham Feldman, Trustee of Nancy Ilene Feldman Gimbel; Jack Feldman, Trustee under the Will of Edward Feldman; Mercantile Safe Deposit & Trust Co., Trustee of Suzanne Louise Feldman; Mercantile Safe Deposit & Trust Co., Trustee of Nancy Ilene Feldman Gimble; and Mercantile Safe Deposit & Trust Co., Trustee under Will of Edward Feldman.

(hereinafter "Webster-Md."). Alternatively, the Feldmans pray in the Maryland suit for money damages in amounts up to $2.7 million solely against Subsidiary for breaches of covenants and agreements made by Subsidiary to the Feldmans.

The merger transaction giving rise to the Feldmans' suit was in the form of a triangular three-party merger which conformed to the requirements of the hybrid "Type A" form of tax-free reorganization as provided by the Internal Revenue Code, 26 U.S.C. §§368(a)(1)(A) and 368(a)(2)(D). The hybrid "Type A" merger permits a subsidiary to exchange its parent's stock for shares of a third corporation being acquired in a statutory merger in which the third corporation is merged into the subsidiary.

Subsidiary was newly created by Beck for the purpose of entering into the merger transaction. Subsequent to the merger Subsidiary continued to operate the business of Webster-Md. in substantially the same manner as the latter had been operated prior to the merger. It traded under its own name (Webster Clothes, Inc.), had its own assets, creditors and obligations. It has substantial assets in the State of Maryland, consisting of leasehold interest in retail stores and its factory, trade fixtures and factory equipment, inventory, stock of its own subsidiaries, bank accounts, and other sundry assets used by it in the conduct of its business. It continuously and consistently held itself out to the general public and trade creditors as being separate and distinct from Beck. There has never been a commingling of assets or functions between Beck and Subsidiary, nor has the corporate form ever been disregarded by the corporations.

Although Beck and its Trustees in reorganization are not named as defendants in that suit, and no relief is prayed against Beck or its property, the Trustees moved, by ap-

plication and order to show cause, for an order enjoining the Feldmans from taking any further steps or actions in connection with the Maryland suit or from otherwise interfering with the possession or management by the Trustees of Beck's estate. The Petitioners alleged in their application that the Feldmans should be restrained from prosecuting their suit because the stock of Subsidiary was a valuable asset of Beck's estate and, if the Maryland Court permitted the Feldmans to rescind the merger, Beck would lose its substantial equity interest in Subsidiary. They further alleged that the Maryland suit was an attempt by the Feldmans to circumvent the order issued by the District Court on May 27, 1971, approving Beck's petition for reorganization under Chapter X of the Bankruptcy Act and enjoining all persons from, *inter alia*:

> ". . . commencing or continuing any action at law or suit or proceeding in equity against said debtor or said trustees in any court, * * * and from doing any act or thing whatsoever to interfere with the possession or management by said debtor or said trustees of the property and assets of the within estate, or in any way interfere with said trustees in the discharge of their duties herein, or interfere in any manner during the pendency of this proceeding with the exclusive jurisdiction of this Court over said debtor and said trustees and their respective properties . . ."

The Referee in Bankruptcy granted the Petitioners' petition and enjoined the Feldmans from continuing with the prosecution of the Maryland suit. The Referee found that the assets of Subsidiary constituted "property" of Beck within the meaning of the Bankruptcy Act and, thus, that the Bankruptcy Court had jurisdiction to enter the order. The Referee acknowledged that the Bankruptcy Act does not authorize the enjoining of the prosecution of a suit against a debtor's independent subsidiary by a creditor thereof.

However, he held that Subsidiary's separate existence should be ignored and its corporate veil pierced because Subsidiary was a mere adjunct or instrumentality of the debtor (Appendix to Petition, p. 11a).

The affirmance by the District Court of the Order of the Referee was reversed by the Court of Appeals. The court held that since Beck's sole interest in Subsidiary is its ownership of Subsidiary's outstanding stock, "absent proof that Subsidiary was a mere sham or conduit rather than a viable entity, the Maryland suit is not a 'proceeding to enforce a lien upon the property of the debtor' as that phrase is used in §516 of the Bankruptcy Act and the Bankruptcy Court therefore lacks jurisdiction" (Appendix to Petition, p. 33a).

After examining and appraising the evidence in the record, the court found that the Petitioners had failed completely to demonstrate that Subsidiary was a sham corporation or an alter ego of its parent. The court said:

> ". . . where a debtor seeks to pierce that veil on the ground that its subsidiary is a mere dummy or alter ego, the burden of proof is on the debtor. Upon the record before us the Trustees failed completely to sustain that burden. On the contrary, it is apparent that Subsidiary was formed for the *mutual* benefit of the parties and that thereafter, far from being a 'mere instrumentality' of Beck, it operated as a viable, independent going commercial concern." (Original emphasis) (Appendix to Petition, pp. 34a-35a).

ARGUMENT

The real issue in the present case is whether or not the Petitioners met their burden of proof in the lower court that Subsidiary was a mere dummy, alter ego or instrumentality of Beck. Without proof to that effect, the Bankruptcy Court was without jurisdiction under the Bankruptcy Act to disregard the separate corporate existence of Subsidiary. It simply

could not take the extraordinary step of treating Subsidiary's property as that of Beck for the purpose of restraining the Feldmans from prosecuting their suit against Subsidiary for rescission of the merger agreement or, alternatively, for damages. As shown hereinafter, the decision of the Court of Appeals was manifestly correct on the issue of fact presented.

The Petitioners do not assert that the decision below is in direct conflict with a decision of another Court of Appeals on any question of law material to the case, nor is there any important question of federal law requiring decision by this Court.

I.

THE DECISION BELOW IS CLEARLY CORRECT.

Under Section 111 of the Bankruptcy Act, 11 U.S.C. §511, the Bankruptcy Court in Chapter X proceedings has "exclusive jurisdiction of the debtor and its property wherever located." Under Section 116(4) of the Act, 11 U.S.C. §516(4), the court may enjoin or stay "a suit against debtor or its Trustee or any act or proceeding to enforce a lien upon the property of the debtor." The Court of Appeals noted that Beck's sole interest in Subsidiary is its ownership of Subsidiary's outstanding stock and that "[o]wnership of all the outstanding stock of a corporation, however, is not the equivalent of ownership of the subsidiary's property or assets" (Appendix to Petition, p. 30a).

Thus, the court held that the Feldman's Maryland suit may affect the *value* of Beck's stock in Subsidiary if the Feldmans obtain a decree or judgment against Subsidiary, but that this will not in any way affect Beck's right, title, interest or ownership in and to its stock in Subsidiary. The court said:

"If rescission were granted in the Maryland action, Subsidiary would be ordered to return to Webster-Md. the assets which Subsidiary had obtained from Webster-Md. as a result of the merger and to return to the former Webster-Md. stockholders the Webster-Md. shares which Subsidiary had received from them in exchange for the 84,388 Beck shares transferred by it to them. In return, Subsidiary would receive back the 84,388 shares of Beck stock, which concededly are worth very little. Beck would still own the stock of Subsidiary, but the assets of Subsidiary would be worth much less. If, rather than rescission, damages were granted, Beck would still own the stock of Subsidiary, but the value of Subsidiary would be reduced by a sum approximating the amount of the damages. In either event Beck would not be deprived of its property, i.e., Subsidiary's outstanding shares. Admittedly there is no attempt by the Maryland plaintiffs to impress a lien upon the shares of Subsidiary owned by its parent-debtor (Beck) or to obtain relief against the debtor. The sole affect of a judgment against Subsidiary, therefore, would be to lower the value of Subsidiary's outstanding shares" (Appendix to Petition, pp. 32a-33a).

The parties, the Referee and the District Court agreed that Section 116(4) of the Bankruptcy Act, 11 U.S.C. §516(4), does not authorize the Chapter X Court to enjoin a suit against a solvent independent subsidiary of the debtor merely because its stock is held by the debtor in reorganization. Indeed, in the Petitioners' Brief to the Court of Appeals they stated the applicable general rule of law regarding the Bankruptcy Court's jurisdiction over a subsidiary of a debtor as follows:

"The general rule concerning the jurisdiction of a reorganization court, vis-a-vis a wholly-owned solvent subsidiary of a parent debtor, is stated in 6 *Collier on Bankruptcy*, p. 500 (14th Ed. 1972):

"'[I]n the case where subsidiary is not undergoing reorganization . . . the jurisdiction of the court

> wherein the parent's proceeding is pending presents special problems in relation to the subsidiary. *Except in circumstances in which parent and subsidiary are so completely "one" that their corporate veil may be pierced with impunity and technicalities laid aside*, the tenancy of the courts, in general, is to interpret their jurisdiction over the debtor parent as limited to the parent's property ownership, i.e., to the stock held by the parent corporation.'" (Original emphasis) (Brief for Appellees, In the United States Court of Appeals for the Second Circuit, pp. 11-12).

The Court of Appeals found that, consistent with the aforesaid general rule, established in the Second Circuit in the leading case of *In Re Adolph Gobel, Inc.*, 80 F.2d 849 (2d Cir. 1936), absent a showing by the Petitioners that Subsidiary was a mere sham or alter ego of Beck, the present case is governed by the general rule, since the Maryland suit is directed solely against Subsidiary and not against any property of Beck (Appendix to Petition, p. 32a).

The Court found as a fact that subsequent to the merger Subsidiary has been a vital, viable and independent entity; and it held that the Referee's characterizations of the subsidiary as a "devious . . . legal rigmarole," and "independent entity by the sheerest fiction," and a "adjunct or instrumentality of the parent, Beck" were unsupported by the record and clearly erroneous (Appendix to Petition, p. 36a). The Court found that:

> (1) "[T]he record reveals a carefully constructed commercial transaction in which parties of relatively equal bargaining strength, represented by able counsel, negotiated and bargained for a distinct operating subsidiary that was to conduct its own independent business . . . ."; and
>
> (2) "[A]lthough Subsidiary was a child of the merger, it was conceived and created by the two parties as a

viable operating entity pursuant to a perfectly legitimate business arrangement from each mutually deprived benefits" (Appendix to Petition, pp. 36a, 39a).

II.

THERE IS NO CONFLICT OF DECISION.

The Petitioners do not assert that the decision below is in direct conflict with the decision of another Court of Appeals on any question of law material to the case. Petitioners merely assert that there is a conflict "in principle" among the decisions of the Third Circuit in *In Re Pittsburgh Rys. Co.*, 155 F.2d 477 (3d Cir.), *cert. den. sub nom, Philadelphia Co. v. Guggenheim*, 329 U.S. 731 (1946) and in *In Re Imperial "400" National, Inc.*, 429 F.2d 671 (3d Cir. 1970).

Contrary to the assertion of the Petitioners, the aforesaid decisions of the Third Circuit are in complete harmony with the law as applied by the Court of Appeals below; namely, absent a showing that a subsidiary is a mere sham, alter ego or instrumentality of a debtor corporation in reorganization or that the subsidiary and the debtor are so completely "one", the Chapter X court is not authorized under the Bankruptcy Act to enjoin a suit against a solvent independent subsidiary of the debtor merely because its stock is held by the debtor in reorganization.

In Re Pittsburgh Rys. Co., supra, involved reorganization proceedings of the Pittsburgh Railways Co., the operating company of the Pittsburgh street railway system (hereinafter "the Railway System"). The Railway System was comprised of a highly involved financial structure and complicated inter-relation of many companies. Philadelphia Company, the holding company parent of the operating company, Pittsburgh Railways Co., through various agreements with several other corporations effectuated a single unified railway system by having all the properties of the

corporations transferred to the possession of Pittsburgh Railways for operation. With the growth of the city came expansion of the Railway System. New companies, denominated by the court as "underliers", were created in which the Philadelphia Company controlled all the stock and had directorate majorities through interlocking. These underlying companies secured the available new franchises and were then taken into the Railway System. The issue before the Court was whether or not the reorganization court had the power to bring into the reorganization the underlying companies having franchises for routes which were a part of the Railway System. The underliers argued that they were still the owners in fee of the property leased to the operating company in reorganization, and thus it was not possible to get these properties into the reorganization court on the basis that they were the properties of the debtor which actually operated them. The court said:

> "As we see the question, the issue is whether the demand of the facts is to control or whether obeisance must be made to the doctrine of the separate corporate entities of all these concerns which, from the business point of view, constitute one operation and one enterprise." 155 F.2d at 482.

The Court concluded that under the facts of that case it was warranted in disregarding the separate identities of the underlying companies. The court stated:

> "Our conclusion is that the facts of the present case call for the treatment of this great transportation system as one entity for purposes or reorganization, regardless of the elaborate jig-saw puzzle arrangement of all the underlying companies which have gone into it. *In so concluding we emphasize the nearly half century of physical operation of this enterprise as a unit, with the interchange of movable property, routes, operating personnel and everything involved on the business side . . . We think that the many years of factual*

unity and the public necessity for the measures which will insure the proper economic foundation for the system, override the arguments for the recognition of the legal concept of separate entity on the part of the undeliers." 155 F.2d at 485 2d at 485 (Emphasis supplied).

In Re Pittsburgh Rys. Co., supra, is completely distinguishable on its facts from the instant case. Unlike in *Pittsburgh* where there was a complete unity between the parent debtor and its subsidiaries, here the undisputed facts are that Subsidiary was conceived and created as a viable, independent entity pursuant to a perfectly legitimate business arrangement and that it, in fact, operated as such at all times. That case merely illustrates that the general rule regarding separate corporate entities is flexible and that the corporate form will be pierced when the equities so require.

In *In Re Imperial "400" National, Inc., supra,* the corporation in Chapter X proceedings, Imperial "400", had as its principal business the construction, furnishing and operation of a chain of motels throughout the United States under the name "Imperial '400' Motels". The motel chain consisted of one hundred sixteen (116) motels located in thirty-five (35) states. Ninety-seven (97) of these motels were owned by partnerships formed under partnership agreements between Imperial and co-owner operators; eight were completely owned by Imperial; and eleven were operated under franchise and license agreements. More than three years after the appointment of a Trustee for Imperial "400" by the New Jersey court, the appellants, the Kuballs, filed a bankruptcy petition in Michigan on behalf of a partnership which owned one of the "Imperial '400' Motels" in Michigan. The Kuballs owned a twenty-five percent interest in the partnership, as general partners. Imperial owned a fifty percent interest as a general partner and a twenty-five percent interest as a limited partner. The issue before

the Court of Appeals was whether the District Court in New Jersey had jurisdiction to enjoin the Michigan bankruptcy proceeding and to transfer the proceeding to New Jersey. The Court of Appeals held that since the New Jersey court had jurisdiction of Imperial, a partner in the Michigan motel partnership, the New Jersey court also had jurisdiction of the partnership motel property and was entitled to enjoin bankruptcy proceedings filed in Michigan by other partners in the Michigan partnership. The bases for the court's decision were as follows:

1. A liquidation of the Michigan partnership would directly affect the debtor's estate (a) since Imperial, as a general partner, would be liable for partnership debts which could not be paid from partnership assets, and (b) the agreement between the Kuballs and Imperial provided that they were tenants in common in the "Motel Business" and that Imperial had the unrestricted right to transfer its interest in the partnership. Under Section 111, of the Bankruptcy Act, 11 U.S.C. §511, the reorganization court's jurisdiction extends to "property" of the debtor wherever located. And under Section 70(a)(5) of the Bankruptcy Act, 11 U.S.C. §110a(5), the Trustee has title to "property, including rights of action, which prior to the filing of the petition . . . could by any means have [been] transferred . . . levied upon, or sold under judicial process . . ." Since the Motel Business and the partnership were identical, and Imperial had the unrestricted right to transfer its interest, the Court of Appeals concluded that Imperial's interest was alienable and the provisions of Section 70(a)(5) were satisfied; and

2. The Bankruptcy Act contemplates the jurisdiction of partners and the partnership in the same court. Section 5c of the Bankruptcy Act, 11 U.S.C. §23(d), provides that "The

court of bankruptcy which has jurisdiction of one of the general partners may have jurisdiction of all the general partners and of the administration of the partnership and individual property." Thus, the Kuballs' argument that there was no jurisdiction in the New Jersey court over the partnership or partnership property was without merit. The New Jersey court in the Chapter X proceeding had jurisdiction of Imperial, a partner. It, therefore, had jurisdiction of each of the partnership motels.

The *Imperial* case is in no way analogous to the instant one. First, since Beck's interest in Subsidiary is limited solely to its outstanding stock, if the Feldmans are successful in rescinding the merger between their corporation and Subsidiary, or successful in obtaining a money judgment against Subsidiary, neither Beck nor its property is directly affected. Unlike in *Imperial*, involving the liabilities of general partners, Beck would not be liable for any amounts which could not be realized from Subsidiary's assets. Second, Beck's interest in Subsidiary is limited to its outstanding stock. As a stockholder, Beck has no right, title or interest in the assets of Subsidiary, and, therefore, no "property" of Beck would be affected by a judgment against Subsidiary. In *Imperial*, the debtor, by agreement, had the unrestricted right to transfer its general partnership interest. The court concluded that the motel business and its partnership interest were identical. Third, whereas the Bankruptcy Act specifically provides that the court take jurisdiction of the partners and the partnership in the same court, there is no such provision of the Bankruptcy Act dealing with parent corporations and their solvent subsidiaries.

The Petitioners have shown neither a direct conflict of decision among the Courts of Appeal nor one "in principle".

Rather, their argument is that the jurisdiction of the court under the Bankruptcy Act should be *extended* to permit the restraining of litigation against an independent, solvent subsidiary of a debtor in reorganization. However, there is no justification in reason or law for this novel proposition, as the court below aptly observed. First, the court noted that:

> "Where a parent corporation desires the legal benefits to be derived from organization of a subsidiary that will function separately and autonomously in the conduct of its own distinct business, the parent must accept the legal consequences, including its inability later to treat the subsidiary as its alter ego because of certain advantages that might thereby be gained. In short, the parent cannot 'have it both ways'." (Appendix to Petition, p. 38a).

Second, conglomerates or holding companies are not new business organizations. They, and the peculiarities of their form and operation, have long been recognized and utilized. Nevertheless, Congress has not seen fit to abrogate the doctrine of separate corporate entities for the purposes of extending the jurisdiction of the Bankruptcy Court as urged by Petitioners. As noted by the court below:

> "We have found that piercing the corporate veil here is not warranted. If it is desirable for the Bankruptcy Court to have jurisdiction of all litigation involving subsidiaries, solvent or not, of the debtor, the answer lies with Congress" (Appendix to Petition, p. 41a).

CONCLUSION

For the foregoing reasons it is respectfully submitted that this Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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